Supreme Court, U.S.
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No. 97-1333

In The

# Supreme Court of the United States

October Term, 1997

RUBEN R. SMITHWICK, JR.
AND DEBBIE SMITHWICK,

*Petitioners,*

v.

GREEN TREE FINANCIAL
SERVICING CORPORATION,

*Respondent.*

**On Petition For Writ Of Certiorari
To The United States Court Of Appeals
For The Fifth Circuit**

## RESPONDENT'S BRIEF IN OPPOSITION

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## QUESTION PRESENTED FOR REVIEW

Respondent has asked this honorable Court to announce the correct rule for bankruptcy courts to apply in a Chapter 13 bankruptcy proceeding, where the debtor has elected under 11 U.S.C. § 1325(a)(5)(B) to retain property which is fully secured by a purchase money lien, and the bankruptcy court must determine the interest rate necessary to assure that the fully secured creditor will receive the full value of the creditor's allowed secured claim.

## LIST OF ALL PARTIES TO THE PROCEEDING

Ruben R. Smithwick, Jr. and Debbie K. Smithwick (Petitioners)

Green Tree Financial Servicing Corporation (Respondent)

Corpus Christi Bankruptcy Trustee Cindy Boudloche

United States Trustee, Houston, Texas

Barbara Kurtz, Office of the United States Trustee, Corpus Christi, Texas

The sole parent corporation of Respondent Green Tree Financial Servicing Corporation is Green Tree Financial Corporation. There are no wholly owned or partly owned subsidiaries of Respondent Green Tree Financial Servicing Corporation.

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## STATUTES AND RULES INVOLVED

### STATUTES

**Section 506 (11 U.S.C. § 506)**

**§ 506. Determination of secured status.**

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

**Section 1322 (11 U.S.C. § 1322)**

**§ 1322. Contents of plan.**

. . .

(e) Notwithstanding subsection (b)(2) of this section and sections 506(b) and 1325(a)(5) of this title, if it is proposed in a plan to cure a default, the amount necessary to cure the default, shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.

**Section 1325 (11 U.S.C. § 1325)**

**§ 1325. Confirmation of plan.**

(a) Except as provided in subsection (b), the court shall confirm a plan if –

. . .

(5) with respect to each allowed secured claim provided for by the plan –

. . .

(B)(i) the plan provides that the holder of such claim retain the lien securing such claim; and

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or

(C) the debtor surrenders the property securing such claim to such holder;. . . .

## RULES

United States Bankruptcy Court, Southern District of Texas

Local Bankruptcy Rule 3020(d)

The interest or discount rate on deferred payments made though a confirmed Chapter 13 plan must equal two percent (2%) plus the prime rate set in the Money Rates Section of the Wall Street Journal on the date the petition initiating the Chapter 13 case was filed.

## STATEMENT OF THE CASE

Petitioners, the Smithwicks, filed a voluntary petition under Chapter 13 of the United States Bankruptcy Code on February 15, 1995. In their plan of reorganization, Petitioners elected to retain possession of the mobile home on which Respondent Green Tree Financial Servicing Corporation had extended a loan. Green Tree holds a purchase money security interest in the mobile home. Petitioners concede that the value of the collateral is greater than the outstanding debt, and that Respondent is thus an oversecured creditor.

Respondent filed an objection to Petitioners' plan of reorganization. Some of Respondent's objections were cured when Petitioners filed an amended plan, providing for continuation of the full principal amount of the loan extended by Respondent. However, the plan continued to provide for interest on the post-confirmation debt to accrue at 11% per annum, pursuant to the local bankruptcy rule, rather than the contract rate of 12.75%.

The Bankruptcy Court confirmed the plan, over Respondent's objection. The United States District Court for the Southern District of Texas affirmed. On appeal, the United States Court of Appeals for the Fifth Judicial Circuit reversed. The Fifth Circuit Court held that a creditor who is forced to accept a further delay in payment of its debt, where the bankrupt debtor elects to retain the collateral, is entitled to receive "the creditor's current rate for a loan of similar character, amount, and duration." The interest rate set forth in the contract is presumed to be the correct rate of interest unless the parties produce evidence that the creditor's current rate is different. After an unsuccessful motion for rehearing in the Fifth Circuit, Petitioners timely sought discretionary review by petitioning this honorable Court.

## SUMMARY OF THE ARGUMENT

1. The honorable United States Supreme Court should decline review. The Court declined review of this same general issue long ago. The Court of Appeals in this case has followed the prevailing view of the United States Courts of Appeal which have addressed this general issue.

2. The honorable United States Supreme Court should decline review because this case, though important to the parties and creditors, is not an "important matter" within the meaning of Supreme Court Rule 10 (a).

3. Alternatively, if this honorable Court grants the petition for writ of certiorari, the Court should affirm the

result reached by the Fifth Circuit. An oversecured creditor, forced to accept a deferred recovery of its property, is entitled to receive its current contract rate of interest.

## ARGUMENT

**1. The Court should decline discretionary review. A clear majority of the United States Courts of Appeal have adopted the approach taken by the Fifth Circuit Court of Appeals in this case.**

Conflicts among the courts of appeal need not be resolved by intervention of this Court. The courts of appeal are able to see and apply the reasoning of the weight of authority. A majority of the circuits considering this same general issue, under the analogous provisions in Bankruptcy Code Chapters 11, 12 and 13, have followed the approach used by the Fifth Circuit Court in this case. *See, e.g., Green Tree Financial Servicing Corp. v. Smithwick,* 121 F.3d 211, 214 (5th Cir. 1997); *Koopmans v. Farm Credit Services of Midamerica,* 102 F.3d 874, 875 (7th Cir. 1996); *General Motors Acceptance Corp. v. Jones,* 999 F.2d 63, 67 (3rd Cir. 1993); *United Carolina Bank v. Hall,* 993 F.2d 1126, 1130 (4th Cir. 1993); *Hardzog v. Federal Land Bank,* 901 F.2d 858, 860 (10th Cir. 1990); *United States v. Southern States Motor Inns,* 709 F.2d 647, 653 (11th Cir. 1983), *cert. denied,* 465 U.S. 1022, 79 L.Ed.2d 680, 104 S.Ct. 1275 (1984). *Compare General Motors Acceptance Corp. v. Valenti,* 105 F.3d 55, 64 (2nd Cir. 1997); *Farm Credit Bank v. Fowler,* 903 F.2d 694, 697-98 (9th Cir. 1990); *United States v. Doud,* 869 F.2d 1144 (8th Cir. 1989).

Even in the contrary authorities cited above, the circuits have agreed that a debtor must pay "full value" of the creditor's claim, including interest on the deferred payment. *See Valenti,* 105 F.3d at 59. The circuits are likewise virtually unanimous in requiring the debtor to pay a "market rate" of interest beginning at the date the reorganization plan is confirmed. *See Doud,* 869 F.2d at 1146. The minority view among the circuits is simply that the market rate should be calculated according to a formula obtained by finding a "risk-free" rate of interest, then adding a "risk factor." This minority view is reflected in local rule 3020(d) of the Southern District of Texas Bankruptcy Rules, and was successfully challenged in this case.

The clear majority view among the circuits applies the approach of the free market. Under that view, the "market rate" of interest to be paid on the deferred payments is the current market rate for similar loans; that is, loans for the same purpose, secured by the same type of collateral, in the same geographic area. That is the result reached by the Fifth Circuit Court in this case.

The Supreme Court has previously declined consideration of this issue in *Southern States Motor Inns,* 709 F.2d 647, *cert. denied,* 465 U.S. 1022 (1984). The Court should not choose this case to consider the issue presented, since in this case, the opinion below conforms with the *Southern States Motor Inns* approach. If the Court is inclined to grant certiorari to determine the question presented, consideration should be deferred until a case is presented which holds contrary to the great weight of authority on this issue. This is not that case.

**2. The question presented does not satisfy the "importance" requirement of Rule 10.**

Supreme Court Rule 10 requires a "compelling" need for there to be uniformity among the circuits in the question presented. While some circuits do not agree with the prevailing view of how the "market rate" should be determined, these differing views do not significantly affect the ability of businessmen to conduct their affairs. Consumer loans and business loans will still be made at prevailing market rates, and debtors will still declare bankruptcy and seek to reorganize their financial affairs. Lenders and borrowers will rarely consider, at the outset of a lending relationship, the likely post-confirmation interest rate should the debtor declare bankruptcy and elect to retain the collateral and make deferred payments to retire the secured debt. Although this Court has jurisdiction, the narrow question presented is not an "important matter" which this Court need decide. Supreme Court Rule 10(a).

**3. The Court below reached the correct result.**

When a bankrupt debtor chooses reorganization rather than liquidation, his relief in most cases is guided by Chapters 11, 12, or 13 of the Bankruptcy Code. A debtor who seeks to retain ownership of some item of property may do so, and may even prevent the right of a secured creditor to foreclose on its security interest in that property. Thus, a secured creditor may not enforce his rights in his collateral, unless the debtor allows it. The debtor has the election. He may surrender the collateral and be free of the debt, or he may retain the collateral and

pay the debt. However, the debtor is only required to pay the debt to the extent that the creditor has security. 11 U.S.C. § 506(a). If the value of the collateral exceeds the debt, the debtor must pay the entire debt. 11 U.S.C. § 506(b). If the debt is only partly secured, the debtor may retain the collateral and pay only the value of the collateral. Under the similar provisions of Chapters 11, 12, and 13, this partial payment by the debtor is referred to as a "cramdown" of the debt. *See* 11 U.S.C. § 1129(b)(2)(A)(i)(II); 11 U.S.C. § 1225(a)(5)(B)(ii); 11 U.S.C. § 1325(a)(5)(B)(ii).

"Cramdown" is an unfortunate colloquialism in bankruptcy practice. *See Valenti,* 105 F.3d at 58. It is not always accurate. Where the creditor is oversecured in a bankruptcy proceeding, the debtor must pay the entire debt in order to retain possession of the collateral securing the debt. Because the debtor is entitled to make the election to surrender the collateral for foreclosure or retain the collateral and pay down the debt over an extended period, courts have frequently referred to the debtor's election to retain the collateral as a "coerced loan." *See General Motors Acceptance Corp. v. Jones,* 999 F.3d at 67.

At least in cases where the creditor is oversecured, a debtor should not be allowed to retain the collateral and pay off the debt at an interest rate below what a non-bankrupt consumer would have to pay. The amount the creditor is to receive must be determined according to the underlying agreement. 11 U.S.C. § 1322(e).

The court below, and other courts, refer to the appropriate rate as a "discount" rate. 121 F.3d at 214. While that

term would be accurate for an economist when discussing the concept of "present value," among many lawyers the term "discount" is and has been misleading. A fully secured creditor is simply entitled to receive interest on its debt, and that interest rate should be a market rate based on the market for the type of loan involved.

Prior to the bankruptcy, the free market determined the appropriate rate of interest for the loan. The market for loans of a similar type in the same area should also determine the interest rate upon confirmation of the bankruptcy plan. "While the cases considering the issue are fairly uniform in agreeing that a market rate of interest is appropriate, the cases differ drastically in their interpretation of how a 'market rate' is to be determined." *Hardzog v. Federal Land Bank of Wichita*, 901 F.2d 858, 859 (10th Cir. 1990), *quoting 5 Collier on Bankruptcy* § 1225.03 at 1225-21 (1989).

The Fifth Circuit in this case reached the correct result, though unfortunately referring to the debtor's election as a "cramdown" and describing the market rate of interest as the "discount rate." The result should be left undisturbed by this Court, so that the great weight of authority continues to apply a concept of the "market" rate of interest as one which applies the rate for loans of similar amount, character, and duration.

The contrary approach, setting the post-confirmation interest rate at a "prime" rate plus some small risk factor such as two percent (2%), encourages the bad-faith filing of bankruptcy petitions. *See General Motors Acceptance Corp. v. Valenti*, 105 F.3d at 63. This is sometimes referred to as a "costs of funds" approach. *See United Carolina Bank v. Hall*, 993 F.2d at 1130. If this "cost of funds" approach is

used, the debtor is allowed to maneuver himself into a better-than-market loan on collateral he wishes to keep, simply by filing bankruptcy. He thereby makes a loan which he could not make before filing bankruptcy. Such a scheme subverts the operation of the free market, and unfairly penalizes secured creditors. Through bankruptcy, a creditor is denied the right to foreclose on his collateral. The statements of some courts that a creditor makes a "profit" by continuing to receive interest on his deferred recovery is wrong. *See Koopmans*, 102 F.3d at 876.

## CONCLUSION

Respondent Green Tree Financial Servicing Corporation respectfully submits that the Court of Appeals reached the correct result in deciding the question presented by Petitioner for review. Respondent therefore requests that the United States Supreme Court decline review of this case. Alternatively, should the Court grant the petition for review, Respondent requests the Court affirm the result reached by the Fifth Circuit in this case, for the reasons presented herein.

Respectfully submitted,

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